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The FBAR Penalty: One Court Pushes Back Against the IRS

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posted by **KATHY KENEALLY**

In a "one-size-fits-most" Offshore Voluntary Disclosure Program, the IRS required taxpayers who voluntarily disclosed unreported foreign bank accounts to amend six years of tax returns, pay the tax, a penalty of twenty percent of the tax liability, interest, and in all but a very small number of cases, to pay an additional penalty of twenty percent of the maximum amount in the account in the prior six years "in lieu of" other penalties that might be asserted. While this Program ended on October 15, 2009, in recent days the IRS Commissioner has stated that another program is under consideration. He has warned, however, that the penalties will increase in any new program.

For many taxpayers, the only additional penalty that they would have faced without the benefit of a disclosure program was for failing to file Form TDF 90-22.1, "Report of Foreign Bank and Financial Accounts," commonly called the FBAR. In general, for any year in which a U.S. taxpayer has accounts outside the United States that exceed $10,000 in the aggregate, the FBAR must be filed by June 30 of the following year.

The penalty for willful failure to file an FBAR is the higher of $100,000 or fifty percent of the highest total account balance, imposed annually.

ABOUT

The IRS Watch is a dream-team of tax controversy litigators and taxpayer advocates who are keeping watch on IRS positions and trends as influenced by regulatory changes, Congress and the Courts.
Our blog will emphasize challenges taxpayers face in complying with complex tax rules, taxpayer advocacy and protection of taxpayer rights in the face of IRS efforts to enforce the laws: audits, appeals, collection of tax, civil and criminal tax practice and procedure.
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The penalty for non-willful failure to file an FBAR is $10,000, also imposed annually. For those who acted willfully, the one-time twenty percent penalty is a bargain. For those who were not willful, it would seem unreasonably punitive.

The IRS published a series of "Frequently Asked Questions" for the first program. In FAQ 35, the IRS posed the question: "Will examiners have any discretion to settle cases?" and then answered, in part: "Under no circumstances will a taxpayer be required to pay a penalty greater than what he would otherwise be liable for under existing statutes."

To date, however, the IRS has resisted most arguments that taxpayers who were not willful should not face the twenty percent penalty. A central issue is what it means to be willful. Recently, in *United States v. Williams, Civil Action No. 1:09-cv-437, 2010 U.S. Dist. LEXIS 90794 (E.D. Va.) (September 1, 2010)*, a federal court rejected the IRS's most common arguments. The facts in the *Williams* case were not sympathetic. The defendant opened two accounts at a Swiss bank in the name of a foreign corporation, deposited in excess of $7 million over several years, and earned an additional $800,000. He ultimately pled guilty to tax fraud.

On the Form 1040 federal income tax return, at Schedule B, Part III, there is a question asking whether the taxpayer has an interest in financial accounts in a foreign country. In small print (small even for a tax return), taxpayers who check "Yes" are directed to the FBAR form. The defendant in *Williams* checked "No." The IRS commonly argues that checking "No" is proof of willfulness. The court disagreed, concluding that the defendant's signature on a tax return, standing alone, did not prove that he knew the contents of the return, but is only a factor to consider.

The Swiss authorities froze the defendant's bank accounts at the request of the United States before the FBAR was due for filing, and the court concluded that the government knew about the account without the FBAR. The court also noted that, on advice of tax professionals, the defendant made a series of disclosures to Swiss and U.S. tax authorities, but that none of the lawyers and accountants told him that he should file an FBAR. Because the defendant had little or no motive to conceal the account, the court concluded that he was not willful.

The *Williams* decision involves facts that predate the current IRS efforts to encourage taxpayers to disclose unreported foreign bank accounts, and its efforts to prosecute those who keep their accounts hidden. It has important lessons for where the line should be drawn in imposing penalties on those who come forward.

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